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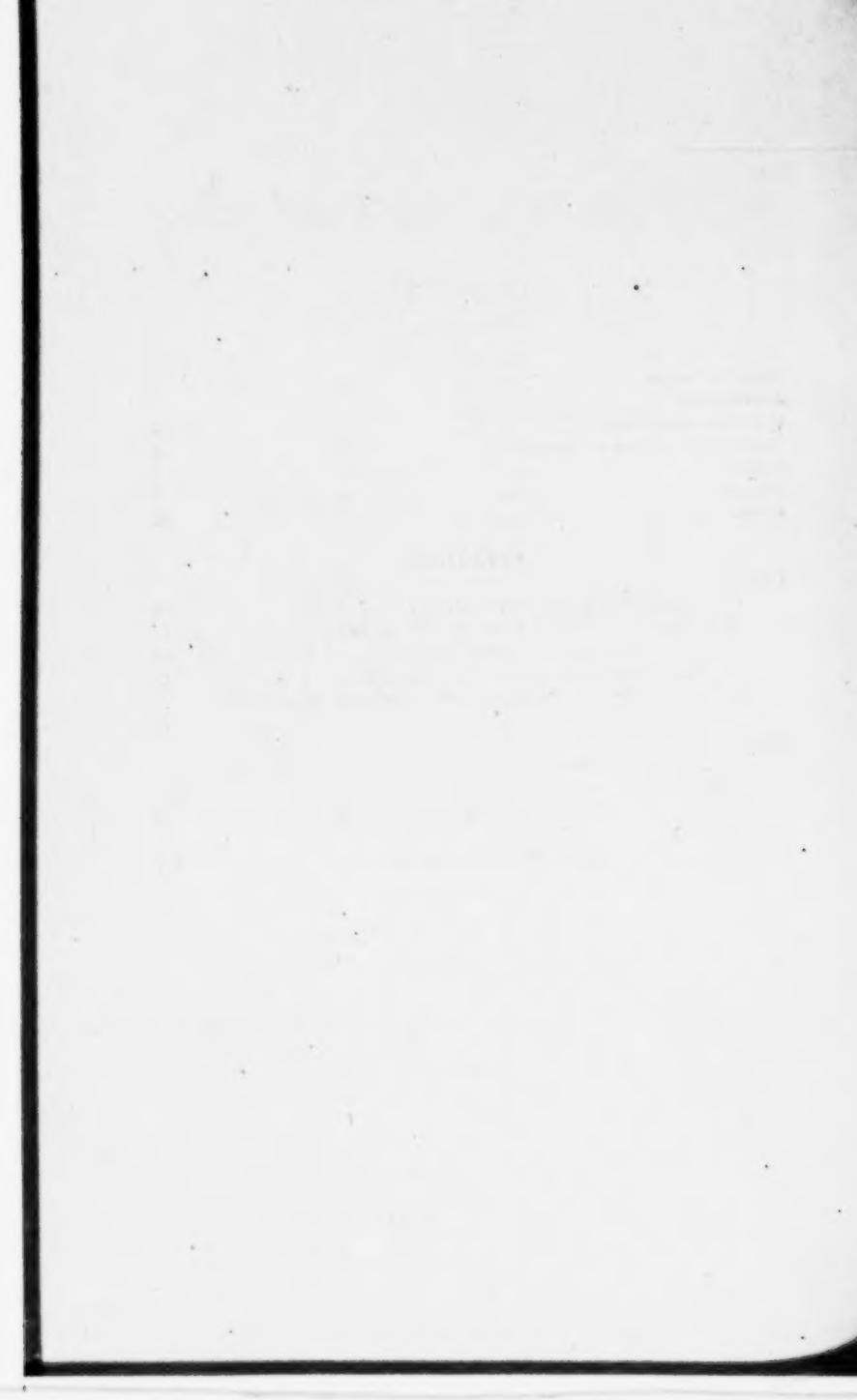
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(1)



In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 758

JOSEPH W. FRAZER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 125-135) is reported in 4 T. C. 1152. The opinion of the Circuit Court of Appeals (R. 150-155) is reported in 157 F. 2d 282.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 9, 1946. (R. 150.) The petition for a writ of certiorari was filed on December 6, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

(1) Where an employer made contributions each year to trusts established for the benefit of its officers and the taxpayer received certain amounts in 1939 upon the termination of his employment, do those amounts constitute compensation for services under Section 22 (a) of the Internal Revenue Code and the applicable Treasury Regulations, for the year 1939 or for earlier years?

(2) Where the amounts so received by the taxpayer purport to represent the proceeds of sale of the taxpayer's certificates of beneficial interest in the trusts, do they represent ordinary income or capital gain?

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *

* * *

(26 U. S. C. 1940 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*— * * *

If property is transferred by * * * an employer to an employee, for an amount

substantially less than its fair market value, regardless of whether the transfer is in the guise of a sale or exchange, such * * * employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of (1) compensation for services rendered * * *

STATEMENT

The facts were stipulated (R. 19-124) and as found by the Tax Court (R. 126-129) are substantially as follows:

The taxpayer is a resident of Grosse Pointe, Michigan. He was, however, at the time of the filing of his income tax return for 1939 a resident of Toledo, Ohio, and his return for that year on a cash receipts and disbursements basis was filed in the office of the Collector of Internal Revenue at Toledo. (R. 126.)

During the year 1929 and at all times subsequent thereto until the effective date of his resignation on January 19, 1939, the taxpayer was an executive of Chrysler Corporation, a Delaware corporation carrying on its manufacturing operations at Detroit. (R. 126.)

By a trust indenture dated April 16, 1929, by and between the Chrysler Corporation as party of the first part, the holders from time to time of certificates for shares of beneficial interest issued under the provisions of the trust indenture

as parties of the second part, and certain individuals named as trustees as parties of the third part, a trust fund was created for the purposes therein mentioned. This trust was and is known as "Chrysler Management Trust." (R. 126-127.)

There have been several amendments to the trust indenture. (R. 127.)

The purposes of the trust are stated in the preamble of the indenture as follows (R. 127) :

Whereas, the Corporation is desirous of adopting and carrying out a plan to attract and retain desirable officers and/or executives and to insure the permanency of sound and efficient management of the Corporation and its subsidiary corporations by enabling such officers and/or executives to become owners of stock of the Corporation on a basis favorable to them; * * *

The principal source of income of the trust fund was to consist of a percentage of the earnings of Chrysler Corporation which should be paid over to the trustees. These earnings were to be invested in shares of the common stock of Chrysler Corporation and other temporary investments. This income consisting of dividends and interest was to be placed in an account called Surplus "A". Contributions to the fund by the corporation and profits from the sale of securities were to be credited to Surplus "B". Distributions were to be made from the trust out of Surplus "A" as the trustees should determine and upon the death

or resignation of any of the officers or executives who were privileged to become members of the trust fund they were, upon surrender of their certificates for shares of beneficial interest, to receive a distribution from the fund, the determination of the amount of which, and whether in cash or securities, was in the absolute discretion of the trustees. (R. 127.)

The taxpayer as an executive of Chrysler Corporation was permitted to acquire certificates for 400 shares of beneficial interest upon the payment therefor of \$25 per share. On October 8, 1929, the taxpayer acquired such certificates upon the payment of \$10,000 cash to the trustees. (R. 127-128.)

In years subsequent to 1929 the taxpayer received large distributions from the trustees upon his 400 shares of beneficial interest. He claimed in his income tax returns that only the excess received by him over his original investment in the trust certificates constituted taxable income. The parties have stipulated that in years prior to 1939 the taxpayer recovered through nontaxable distributions from the trust fund his entire investment of \$10,000 in the 400 shares of beneficial interest in the trust. (R. 128.)

By a second trust indenture dated April 11, 1936, a second trust called "First Adjustment Chrysler Management Trust" was established for the same purposes as the first trust was estab-

lished. The taxpayer was permitted to acquire certificates for 50 shares of beneficial interest in this second trust at a price of \$7 per share and on November 19, 1936, acquired such shares by a payment of \$350. The parties have stipulated that the taxpayer fully recovered his original investment in these shares by nontaxable distributions from the second trust prior to 1939. The taxpayer resigned from his position as an executive of Chrysler Corporation effective January 19, 1939. (R. 128.)

The two trusts referred to above have filed income tax returns upon the calendar year basis from the dates of their creation. In such returns they have reported as taxable income dividends and interest received upon investments but have not included therein contributions consisting of percentages of the earnings of Chrysler Corporation. Such contributions to the end of 1938 have amounted to \$6,488,100.06 in the case of "Chrysler Management Trust" and to \$1,223,071.91 in the case of "First Adjustment Chrysler Management Trust". (R. 128.)

Taxpayer surrendered his certificates of beneficial interests in both trusts on or about April 20, 1939, and received \$54,605.23 from the trustees of the first trust, and \$5,948.54 from the second trust, or a total of \$60,553.77. (R. 129.)

In making his income tax return for 1939 the taxpayer reported his receipt of funds from the

trustees as a capital gain, only 50 percent of which was included in the gross income. The Commissioner included the entire amount of \$60,553.77 as ordinary income of the taxpayer for 1939. He has treated it as compensation for services rendered by the taxpayer taxable at 100 percent. (R. 129.)

The Tax Court held that the portion of the amounts received by the taxpayer in 1939 representing contributions by Chrysler Corporation to the trusts, represented compensation and was therefore taxable in full in the year 1939. The Circuit Court of Appeals affirmed the decision of the Tax Court, with Circuit Judge Miller dissenting.

ARGUMENT

1. Section 22 (a) of the Internal Revenue Code, *supra*, defines "Gross income" as including "gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *" Article 19.22 (a)-1 of Treasury Regulations 103, *supra*, provides:

If property is transferred by * * * an employer to an employee, for an amount substantially less than its fair market value, regardless of whether the transfer is in the guise of a sale or exchange, such * * * employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market

value to the extent that such difference is in the nature of (1) compensation for services rendered * * *

In a recent case this Court held that an employee received compensation under Section 22 (a) upon the exercise of an option given by his employer to buy stock in another corporation at less than its market value. *Commissioner v. Smith*, 324 U. S. 177. In its opinion this Court said (p. 181):

Section 22 (a) of the Revenue Act is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected. See *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 729. The regulation specifically includes in income, property "transferred * * * by an employer to an employee, for an amount substantially less than its fair market value," even though the transfer takes the form of a sale or exchange, to the extent that the employee receives compensation.

Applying this construction of the statute to the facts of this case, it is clear that Chrysler Corporation used the Chrysler Management Trust as a device to permit its officers to buy Chrysler stock on favorable terms. The preamble of the trust indenture expressly says so. (R. 127.) Moreover, the record shows just how favorable the terms were; the taxpayer recovered from the

trusts many times his original investments in the form of dividends and distributions of stock. In regard to the Chrysler Management Trust, the taxpayer paid \$10,000 for his certificates (R. 128), and received distributions of more than \$122,000 in the years 1936, 1937 and 1938 (R. 24), not to mention the final payment of \$54,000 in the taxable year when he surrendered his certificates (R. 129). For every dollar that the taxpayer put in the trust in 1929, he received more than \$17 over a ten-year period.

Likewise, in regard to the First Adjustment Chrysler Management Trust, the taxpayer paid \$350 for his certificates in 1936. (R. 128.) He received distributions of \$1,300 in 1936, 1937 and 1938 (R. 26), and more than \$5,900 in 1939 when he surrendered them (R. 129). For every dollar that the taxpayer put in this trust, he received more than \$20 over a three-year period.

Apparently, the taxpayer does not seriously question the decisions of the Tax Court and of the court below that the amounts received by him in 1939 upon the surrender of his certificates were compensation; his principal argument is that the contributions of Chrysler Corporation were compensation to the taxpayer in the years that the trusts received them, although it should be noted that he did not include those amounts in his income during those years. (Br. 10-15.) The taxpayer had no fixed, indefeasible right to the

contribution made by the Chrysler Corporation under the terms of the trust agreements, to which he was a party, until the termination of his employment. The determination of the amount of the distributions to the beneficiary was prescribed by formula, but in the last analysis was in the discretion of the trustees. (R. 38-39, 80-81, 91-93, 127.) The amount of the distribution depended also upon the manner of terminating the beneficiary's employment. There was no method by which the taxpayer's share of the annual contributions by Chrysler could be calculated in the year that each contribution was made, and the taxpayer has not suggested what that share was. Furthermore, these contributions were to be used by the trustees to buy Chrysler stock at favorable prices, and it was not the intention of the parties to the trust indenture to vest an aliquot part of the contribution in the beneficiaries at the time the contributions were made.

The taxpayer contends (Br. 11-12) that the decision of the court below is in conflict with another decision of the court below, *Hubbell v. Commissioner*, 150 F. 2d 516. In that case the employer of the two taxpayers paid \$25,000 in the taxable year to a bank under a trust agreement with the understanding that the sum was to be paid to an insurance company as premiums on two annuity contracts for the benefit of the taxpayers after they reached 70. The Tax Court and the

court below held that the \$25,000 represented compensation to the taxpayers under Section 22 (a); the court below held that the trustee was a mere conduit and that the payment of the premiums was the equivalent of the payment of cash to the taxpayers. In this case, however, it was impossible, prior to the taxable year, to determine how much of the contributions by Chrysler Corporation to the trusts would finally be given to the taxpayer upon the termination of his employment. The money in the trust was to be invested largely in Chrysler stock and the portion to be awarded to the taxpayer would depend in part upon the market value of the stock at the time of the termination of his employment. No part of the trust corpus was irrevocably set aside for the taxpayer prior to the termination of his employment.

The taxpayer also argues that the decision of the court below is in conflict with the decision of the Second Circuit in *Schaefer v. Bowers*, 50 F. 2d 689, certiorari denied, 284 U. S. 668. (Pet. 5.) That case involved a stock subscription plan by which an employee contributed a percentage of his salary to a fund for five years, at the end of which time he received certain shares of stock. If the employee withdrew from the fund or left the employer's services he would lose his right to the stock and would be entitled only to have his contributions restored. The Second Circuit held that the right to receive the shares was conditional

and therefore did not accrue until the end of the five-year period. We think that the right to receive a distribution of the trust corpus in this case was equally conditional; it depended upon the market value of Chrysler stock, the earnings of the Chrysler Corporation, and the manner in which the officer terminated his employment, to mention only some of the conditions laid down in the trust indentures.

The taxpayer also relies upon the decision of the Eighth Circuit in *Oberwinder v. Commissioner*, 147 F. 2d 255. (Br. 15.) In that case the employer purchased single premium annuity contracts for some of its employees, including the taxpayer, who owned a large majority of the stock of the employer, and delivered the contracts to the employees in the taxable year. The court held that the amount of the single premium constituted income to each employee in the taxable year. In this case, however, the taxpayer's share of the trust corpus could not be determined until the termination of his employment, at which time the Commissioner did include the actual amount of his share in his income.

2. The taxpayer contends that the final distributions to him upon the surrender of his certificates of beneficial interest resulted in capital gain, rather than ordinary income, and relies upon the decision of the court below in *Commissioner v. Alldis' Estate*, 140 F. 2d 885, to support that argu-

ment. (Br. 16-19.) In that case the employee had died and his widow surrendered the certificates and received the decedent's share in the trust. The question was whether the share of the decedent, who was on the cash basis, had accrued up to the date of his death within the meaning of Section 42 of the Revenue Act of 1938. No such question arises in this case. The Tax Court itself had previously decided the *Alldis* case (46 B. T. A. 1171), and its opinion herein plainly distinguishes its prior decision in the *Alldis* case (R. 132-133).

CONCLUSION

The decision of the court below is correct and there is no direct conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

GEORGE T. WASHINGTON,
Acting Solicitor General.

SEWALL KEY,
Acting Assistant Attorney General.

J. LOUIS MONARCH,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

JANUARY 1947.